Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Anderson
Analyst: Angela Raygoza
Bill Number: AB 294

Related Bills: See Legislative History
Telephone: 845-7814
Amended Date: April 14, 2009

Attorney: Patrick Kusiak
Sponsor:

SUBJECT: Defensible Space Deduction

SUMMARY

This bill would provide a tax deduction for amounts paid or incurred to create a defensible space around specified properties.

SUMMARY OF AMENDMENTS

The April 14, 2009, amendments replaced intent language with language that would provide a tax deduction for amounts paid or incurred to create a defensible space.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

It appears the intent of the bill is to encourage taxpayers to protect their homes from wildfires and assist them with complying with the law.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009, and before January 1, 2013.

POSITION

Pending.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Geoff Way for	05/14/09
_______ N	_______ OUA	___X___ PENDING	Selvi Stanislaus	

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses are considered miscellaneous itemized deductions and the portion that exceeds 2 percent of adjusted gross income (AGI) may be deducted.[1] Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

Current state law requires landowners in mountainous, forest, brush, and grass-covered lands to maintain a 30-foot firebreak around homes, buildings, and structures. In addition, current state law requires that around and adjacent to an occupied dwelling or occupied structure, *additional* fire protection or firebreaks out to 100 feet from the dwelling or structure or to the property line be maintained. Greater distances may be required by local ordinance, rule, or regulation.

Under the Code of Civil Procedure, a "dwelling" is defined as a place where a person resides and may include, but is not limited to, the following:

- A house together with the outbuildings and the land upon which they are situated.
- A mobile home together with the outbuildings and the land upon which they are situated.
- A boat or other waterborne vessel.
- A condominium[2],

THIS BILL

For each taxable year beginning on or after January 1, 2009, and before January 1, 2013, this bill would provide a tax deduction in an amount equal to the qualified costs paid or incurred by a taxpayer to create a defensible space under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL). The maximum deduction allowed would be $500 for each qualified property.

This bill would define the following terms:

- "Defensible Space" means the area created by removing all brush, flammable vegetation, and combustible growth that is located within 100 feet of the structural components of a dwelling located on a qualified property.
- "Dwelling" has the same meaning as described by the Code of Civil Procedure[3] but excludes a boat or other waterborne vessel.

---

[1] For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.
[2] Section 783 of the Civil Code defines condominium as an estate in real property.

- “Fire Department” means the local fire department that has jurisdiction over the qualified property.
- “Licensed Contractor” means a contractor with an active license issued by the Contractors’ State License Board.
- “Qualified costs” means 25 percent of the costs paid or incurred by a qualified taxpayer for labor and services performed by a licensed contractor to create a defensible space around a qualified property. The costs would be substantiated by records and documents including, but not limited to, a written certification.
- “Qualified property” means any dwelling located within California.
- “Qualified taxpayer” means any taxpayer that owns qualified property.
- “Written Certification” means a written evaluation by the fire department that certifies the establishment of defensible space, provided that the certification would be obtained within 30 days after completion of the work establishing the defensible space. The taxpayer would be required to retain a copy of the certification and provide it to the Franchise Tax Board (FTB) upon request.

In order to receive a deduction, this bill requires that a qualified taxpayer provide written certification, upon request, to the FTB.

This bill specifies that any deduction allowed under the personal income tax or corporate tax laws should not be reduced by the amount of the deduction for qualified costs allowed under this bill.

Because this bill fails to specify otherwise, this deduction would be considered a miscellaneous itemized deduction and allowed only to the extent that all miscellaneous deductions exceed 2 percent of AGI for state income tax purposes.

This deduction would be repealed as of December 1, 2013.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill uses a term that is undefined, i.e., “structural components.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this deduction.

---

[3] Section 704.710 of the Code of Civil Procedure defines dwelling as a place where a person resides and may include but is not limited to the following: house, mobile home, boat or other waterborne vessel, condominium, planned development, stock cooperative, and community apartments.

This bill would allow a maximum deduction of $500 for costs paid or incurred to clear a defensible space around a qualified property. For example, a single owner would incur costs of $100 after applying the 25 percent limit, but two owners of the same property would receive $100 each for a total of deduction of $200. The bill is silent as to whether in the case of multiple owners the limitations on eligible qualified costs for this deduction would apply to the property or instead to each co-owner. It is recommended the bill be amended to clarify how to apply the deduction limitations in the case of multiple owners for the same property.

This bill would allow a deduction for a clearing a defensible space around a dwelling. It is unclear if the deduction would apply to costs for clearing a defensible space while a dwelling is being built, in addition to existing dwellings. If the author's intent is to allow the deduction to apply only to existing dwellings, it is recommended the bill be amended to clarify that the bill applies to existing dwellings under the definition of "qualified property."

TECHNICAL CONSIDERATIONS

Qualified costs specify the costs would be evidenced by record and documents including, but not limited to, a written certification. As defined in the bill, the written certification would not certify the qualified costs paid or incurred to clear a defensible space, but would instead only provide a written evaluation that a defensible space has been established. Amendments 1-4 have been provided to correct this technical error.

LEGISLATIVE HISTORY

AB 363 (Miller 2009/2010) would create a tax credit for the costs incurred to bring a qualified home into fire safety compliance, as specified. This bill is currently in the Assembly Revenue and Taxation Committee.

AB 424 (Gaines, 2007/2008) would have allowed taxpayers a credit equal to, but no greater than $500, for qualified costs incurred for creating a defensible space around an existing home. This bill failed to pass out of the Senate Revenue and Taxation Committee.

AB 1853 (Anderson, 2007/2008) would have provided a tax deduction for amounts paid or incurred to create defensible space around specified properties. This bill failed passage out of the Assembly Revenue and Taxation Committee.

AB 1912 (Plescia, 2007/2008) would have provided a credit in an amount equal to 15 percent of the costs paid or incurred by a taxpayer for the purchase and installation of any wildfire risk reduction improvement installed on existing property in this state. This bill failed to pass out of the Assembly Revenue and Taxation Committee.

OTHER STATES INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. These states do not have a deduction comparable to the deduction provided in this bill.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 294 Effective for Tax Years Beginning On or After January 1, 2009 Enactment Assumed After June 30, 2009. ($ in Millions)		
2009-10	2010-11	2011-12
-$0.5	-$2.2	-$2.0

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of the bill would depend on the amount of qualified costs deducted on tax returns and the marginal rates of taxpayers deducting such costs.

The Department of Finance reports that 13.3 million qualified properties are located in California. It is assumed that 5 percent or approximately 665,000 owners (13.3 million x 5%) of qualified properties would participate in claiming the deduction on income tax returns during the four years this deduction would be available. For each qualified taxpayer that pays $1,500 as the average cost for a licensed contractor to clear up to 100 feet of defensible space there would be approximately $250 million in potential deductions [($1500 x 25% limitation) x 665,000].

This estimate assumes that 20 percent or approximately $50 million of the $250 million in total deductions would be deducted by business entities ($250 million x 20%). Applying a corporate tax rate of 8 percent would result in approximately $4 million in business entity tax revenue losses ($50 million x 8% = $4 million). Based on departmental data, it is assumed that 16 percent of the deduction attributable to individuals, or $32 million [($250 million - $50 million) X 16%], could be claimed as miscellaneous itemized deductions. Only expenses in excess of 2 percent of the AGI could be claimed as a miscellaneous itemized deduction on an individual's income tax return. Applying a 6.25 percent marginal tax rate to the remaining deduction of $32 million would result in a $2 million ($32 million x 6.25%) individual tax revenue loss.

The revenue loss is projected to be approximately $6 million over four years ($4 million business entity losses + $2 million individual losses). Because of the required certification process, it is assumed approximately $300,000, or 5 percent, would be claimed in tax year 2009, $2.1 million or 35 percent in tax years 2010 and in 2011 and $1.5 million or 25 percent in tax year 2012. The estimate in the chart reflects the fiscal year effects of both reduced estimated tax payments and returns filed reporting the deduction.

POLICY CONCERN

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense. In addition, it would provide an incentive to create a defensible space that is required by existing state and federal laws or regulations.

LEGISLATIVE STAFF CONTACT

Legislative Analyst	Revenue Director	Asst. Legislative Director
Angela Raygoza	Jay Chamberlain	Patrice Gau-Johnson
(916) 845-7814	(916) 845-3375	(916) 845-5521
angela.raygoza@ftb.ca.gov	jay.chamberlain@ftb.ca.gov	patrice.gau-johnson@ftb.ca.gov

Analyst Angela Raygoza
Telephone # 845-7814
Attorney Patrick Kusiak

FRANCHISE TAX BOARD’S
PROPOSED AMENDMENTS TO AB 294
As Introduced April 14, 2009

AMENDMENT 1

On page 2, strikeout line 14 and insert:

qualified property, and for which a written certification is required.

AMENDMENT 2

On page 2, strikeout lines 25-26 and insert:

qualified property.

AMENDMENT 3

On page 3, strikeout line 22 and insert:

qualified property, and for which a written certification is required.

AMENDMENT 4

On page 3, strikeout lines 33-34 and insert:

qualified property.